DALLASFED Economic Update
Regional

Texas Economy Faces Cross Currents

June 17, 2016

The Texas economy overall presents a befuddled picture. On the upside, employment growth bounced back in April after nearly halting in March but slowed again in May. Oil prices have increased, the rig count ticked up in early June and Texas exports rose strongly in the first quarter. The Texas Leading Index, which forecasts employment growth for the state, also saw broad-based improvement.

Despite the silver lining, dark clouds remain on the horizon. April exports data showed a decline, and the May Texas Business Outlook Surveys (TBOS) headline indexes weakened from their April readings. Moreover, we are seeing layoffs in Houston—ground zero of the energy bust—affect other sectors of the metro's economy, particularly its residential and office markets.

Employment Growth Resumes

Texas employment grew an annualized 1.5 percent in April and 0.4 percent in May, an improvement over the March figure of 0.1 percent. So far through May, employment has increased at a 1.1 percent annualized pace in line with growth seen in the first five months of 2015 *(Chart 1)*.

The goods-producing sector continued contracting, and persistent declines in drilling have led to year-to-date job losses of 19.7 percent in oil and gas extraction. These, combined with a strong dollar, have also contributed to a 3.3 percent year-to-date drop in manufacturing employment. Construction payrolls have shrunk as well, falling 2.9 percent.

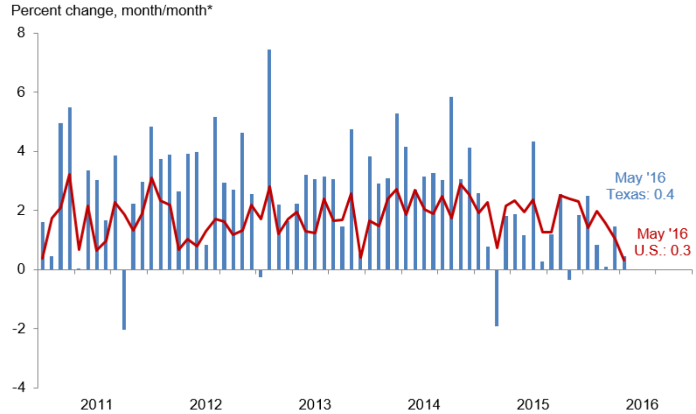
The Texas labor market remains tight overall, with the unemployment rate holding steady at 4.4 percent in May and remaining below the 4.7 percent U.S. rate.

Services Expand, Manufacturing Activity Falters Following Recent Stabilization

The Texas Service Sector Outlook Survey (TSSOS) headline index fell from 10.6 to 5.8, suggesting a positive but slower pace of growth in services. Manufacturing activity contracted in May, according to the Texas Manufacturing Outlook Survey (TMOS). The production index plunged to its lowest level in a year after two months of positive readings, and the new orders index turned negative in May. Somber outlooks and persistently feeble demand suggest further weakness looms ahead.

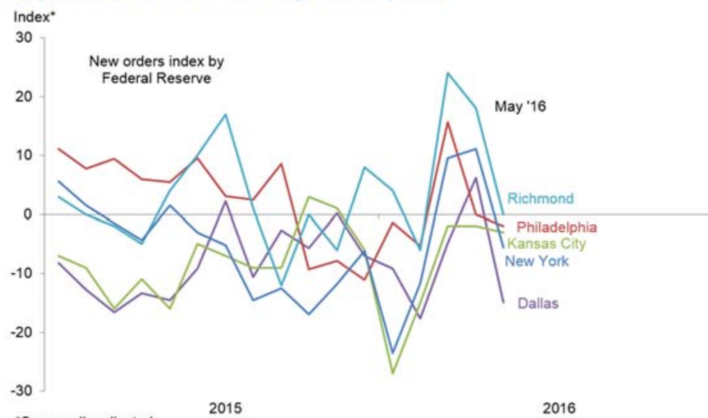
Weakness seen in the May TMOS data is reflected in other Federal Reserve Banks' manufacturing reports as well. New orders indexes across all five Fed surveys were unanimously flat or negative in May following mostly positive readings in March and/or April. This indicates the reversal seen in Texas is not a result of a downturn in the energy sector but rather a general nationwide trend *(Chart 2)*.

Chart 1
Texas Employment Growth Resumes After Pausing in March



*Seasonally adjusted annualized rate.
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal adjustments by Federal Reserve Bank of Dallas.

Chart 2
May Weakness in Manufacturing Is Widespread



*Seasonally adjusted.
SOURCES: Federal Reserve Bank of Dallas; Federal Reserve Bank of Philadelphia; Federal Reserve Bank of Kansas City; Federal Reserve Bank of Richmond; Federal Reserve Bank of New York.

Chart 3
Housing Starts Dip Primarily Due to Falloff in Apartment Construction

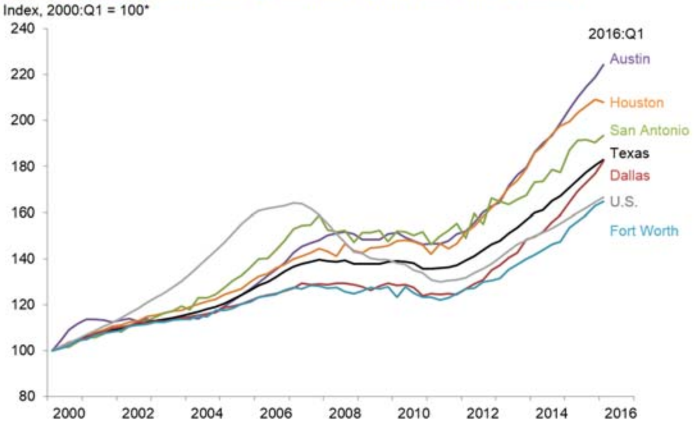
*Five-month moving average.
SOURCES: Bank of Tokyo-Mitsubishi; Census Bureau; F.W. Dodge.

Table 1: Apartment Markets Mostly in Good Shape Except for Houston

Metro area	Occupancy	Rent growth	Net absorption	Units completed	Under construction
	2016:Q1	2016:Q1 / 2015:Q1	2016:Q1 / 2015:Q1	2016:Q1 / 2015:Q1	2016:Q1
Austin	95.5%	5.7%	7,700 units	7,400 units	13,800 units
Dallas–Fort Worth	94.9%	6.1%	15,100 units	18,200 units	43,200 units
Houston	93.3%	2.5%	5,700 units	13,000 units	30,900 units
San Antonio	92.9%	3.8%	4,000 units	4,600 units	8,200 units

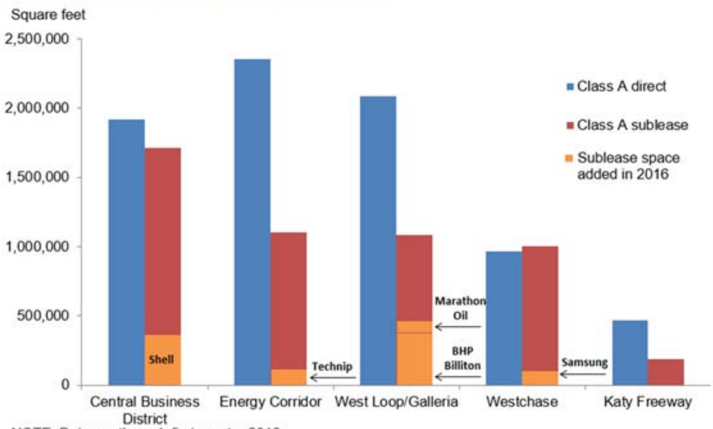
NOTE: Demand is considered strong if net absorption exceeds units completed, rents are rising and occupancy is high.
SOURCE: MPF Research.

Chart 4
Home Prices Dip in the Energy Capital, Up in Other Major Metros



*Seasonally adjusted.
SOURCE: Federal Housing Finance Agency.

Chart 5
Sublease Office Space Piles Up in Houston



NOTE: Data are through first quarter 2016.
SOURCE: CBRE Research.

Higher Oil Prices Boost Texas Exports in the First Quarter but Down in April

Texas exports rose 3.9 percent in the first quarter, posting their largest quarterly gain since fourth quarter 2013. Still, Texas exports remain 1.7 percent below year-ago levels. The value of exports increased largely because of higher prices for oil, gas and their derivatives; exports of petroleum products and chemicals are among Texas' largest export categories. However, other sectors such as computers and electronic products spiked as well, up 11.9 percent in the first quarter. Texas exports declined in April, down 3.4 percent, and U.S. exports fell as well.

Housing Starts Trend Down as Multifamily Construction Takes a Dive

Statewide housing starts, including both single-family and multifamily units, rose 2.7 percent in April but are down from year-ago levels. The five-month moving average also shows a steady decline, a result of a drop-off in new multifamily construction projects. Total multifamily permits are down 13.9 percent so far through April of this year compared with the same period last year *(Chart 3)*. Single-family construction is holding up as the year-over-year increase in DFW new-home starts in the first quarter more than offset the slowdown in Houston, according to Metrostudy.

Home Prices Dip in Houston, Rising in Other Major Metros

The impact of the energy bust on home prices finally became apparent. First-quarter data from the Federal Housing Finance Agency showed a 0.7 percent dip in Houston home prices—its first decline since third quarter 2011 when the housing market was still recovering from the U.S. housing bust *(Chart 4)*. The May Beige Book also reported that builders in Houston were offering discounts and incentives. Prices in other major Texas metros continued to trend upward, with appreciation accelerating in Dallas and Austin.

Apartment Market Fundamentals Mostly Solid Outside of Houston

Apartment demand remains strong, occupancy high and rent growth solid in most major Texas metros *(Table 1)*. This positive momentum in DFW, Austin and San Antonio is expected to continue despite elevated new construction. The weak spot is Houston, where deteriorating conditions are putting downward pressure on rents, especially in submarkets with new Class A apartments in lease-up phase. Conditions are expected to worsen in Houston as thousands of new units are completed and delivered this year amid a weak economy.

Houston's Office Market Woes Run Deep

The Houston office market has been severely impacted by the energy bust. Oil and gas layoffs, along with mergers and acquisition activity, have dampened leasing demand, putting pressure on rents and spiking sublease space that is approaching 10 million square feet in the second quarter. This is nearly triple its 15-year average of 3.8 million square feet, according to CBRE. Houston submarkets such as the West Houston Energy Corridor and the central business district are among the hardest hit *(Chart 5)*.

Outlook Modest

Recent economic data have been varied, but overall indicate continued sluggish growth. The Texas Leading Index rose strongly for the second straight month in April, up 1.4 percent, following four consecutive months of declines. Texas employment forecast now stands at 1.3 percent growth (December/December), on par with last year's increase.

Employment in Houston is projected to contract this year.[1] Fort Worth will likely see continued sluggish job gains due to its higher dependence on energy and manufacturing. Growth in the U.S. economy will provide a tailwind for Texas, particularly for Dallas and San Antonio, which are more similar to the nation in their industrial composition.[2]

—Laila Assanie and Emily Gutierrez

……………………………………………………………………………………….

About the Authors

Assanie is a business economist and Gutierrez is a research analyst in the Research Department at the Federal Reserve Bank of Dallas.

……………………………………………………………………………………….

Notes

1. "Houston Grinds to a Halt as Oil Industry Declines," Jesse Thompson, *Southwest Economy*, Second Quarter 2016.

2. "At the Heart of Texas: Cities' Industry Clusters Drive Growth," Laila Assanie, Kristin Davis, Pia Orrenius and Michael Weiss, Federal Reserve Bank of Dallas Special Report, February 2016.